LMW Electronics Pte Ltd v Ang Chuang Juay & Ors

HIGH COURT (JOHOR BAHRU) — CIVIL SUIT NO (MT-1)–22–833 OF 2007
VERNON ONG JC
29 SEPTEMBER 2009

Companies and Corporations — Directors — Personal liability — Whether directors personally liable to plaintiff for judgment sum obtained against company — Whether business of company had been carried on with intent to defraud creditors or for any fraudulent purpose — Whether defendants were knowingly party to company carrying on business with intent to defraud creditors — Companies Act 1965 s 304(1)

In 2003 IDSM Sdn Bhd ('IDSM'), the fifth defendant had purchased and taken delivery of electronic components ('the goods') from the plaintiff company. When IDSM did not pay for the goods the plaintiff instituted legal action against IDSM for the price of the goods, which amounted to US$90,585.01. In its defence IDSM contended that the goods were defective and not of merchantable quality and counterclaimed for damages. However, in 2006 IDSM abandoned its defence and counterclaim whereupon the plaintiff obtained judgment against IDSM on its claim. The plaintiff now claimed that during the subsistence of its civil action against IDSM, the first, second, third and fourth defendants as directors and/or shareholders of IDSM had unlawfully dissipated the assets and funds of IDSM that left the plaintiff with a mere paper judgment, in that, IDSM was left with no assets to pay the judgment sum when judgment was delivered in the plaintiff's favour on 4 January 2006. Hence the plaintiff commenced the present action against the four directors and/or shareholders of IDSM and sought a declaration that the first to fourth defendants were personally liable, jointly and/or severally to the plaintiff for the judgment sum of US$90,585.01, due and owing by IDSM to the plaintiff and other consequential orders. To support its claim predicated on s 304(1) of the Companies Act 1965 ('the Act)' the plaintiff traced the events that took place in 2003 and 2004, namely how IDSM had downsized its operations in 2003 by selling two units of shop houses and cutting down on manpower; had shifted all of IDSM's physical assets to China Enersave Ltd ('the holding company'), its holding company in Singapore; had by way of a deed of assignment transferred its trade receivables amounting to RM3m to the holding company for no consideration; had written off its stocks, plant and equipment, machinery and trade receivables before finally ceasing operations in December 2004. At

the trial, the auditor who audited IDSM's 2004 audited accounts was unable to verify that the 2004 audited accounts gave a true and fair view of the affairs of IDSM. The auditor also testified that it was unjustifiable and incorrect to write off the stocks to zero value without sufficient supporting documents and to transfer IDSM's trade receivables to the holding company by way of a deed of assignment. In their defence both the first and second defendants denied any personal knowledge of the removal of IDSM's physical assets and of any involvement in the deed of assignment. Evidence was adduced to show that the first defendant had resigned as a director prior to the date of the execution of the deed of assignment and the second defendant was not aware of the existence of the same. The first and second defendants also pleaded that as minority shareholders they were not the decision makers in IDSM. The third and fourth defendants were directors of the holding company who were nominated by the holding company to be directors of IDSM as the holding company's corporate representatives. In effect they were by their own admission the management of IDSM at the material time. The third defendant also admitted that he and the fourth defendant had authorised the deed of assignment to transfer the trade receivables to the holding company but denied writing off the plant, equipment and machinery. In their defence the third and fourth defendants submitted that they had carried out the normal corporate exercise of selling assets and reducing workers in 2004 to cut losses, and that all these acts were done before the plaintiff obtained judgment against IDSM in 2006, and that as such these acts could not be said to have intended to defraud the plaintiff. They further submitted that as they were nominee directors there was no basis for the plaintiff to claim against them under s 304(1) of the Act. The main issues to be considered in this case were whether IDSM had carried out business within the meaning of s 304(1) of the Act and whether the business of IDSM had been carried on with the intent to defraud creditors or for any fraudulent purpose. If these issues were answered in the affirmative it then became necessary to consider whether any one or more of the defendants was knowingly a party to IDSM's carrying on business in that manner.

Held, dismissing the claim against the first and second defendants with costs and the third and fourth defendants personally responsible, jointly and severally to the plaintiff with interest and costs.

(1) The words 'any business of the company has been carried out …' in s 304(1) of the Act had been interpreted to include a myriad of activities and transactions undertaken by a company. IDSM's 2003 audited accounts showed an income revenue of RM6,860,094 but the auditor's report to the 2004 audited accounts stated that IDSM had ceased operations in December 2004. On these facts it was found that IDSM

had carried out business within the meaning of s 304(1) during the period from 1 January 2003 to 31 December 2004 (see para 19).

(2) The words 'with intent to defraud creditors … or for any fraudulent purpose' in s 304(1) should be read disjunctively even though on the facts of the case both limbs are relevant and applicable. Notwithstanding the word 'creditors' in s 304(1), it does not matter that only one creditor was defrauded and that he was defrauded by one transaction. Whether there was an intention to defraud on the part of the defendants is a question of fact to be inferred from the surrounding circumstances and the subsequent conduct of the defendants. In this case the auditor had categorically stated that the accounts had not been properly drawn up in accordance with the provisions of the Act and accounting standards in Malaysia. On this issue there was a dereliction of duty on the part of the directors of IDSM as there was nothing in the notes to the accounts explaining why the profit and loss accounts were not made out in accordance with approved accounting standards (see paras 21 & 24).

(3) It was clear that when IDSM purchased the electronic components from the plaintiff the directors of IDSM knew that there was no reasonable prospect of the plaintiff receiving payment for the purchase price. Further, although IDSM had substantial trade receivables in excess of RM4m, it had decided to write off the same as doubtful debts when in fact the RM3m had been diverted to the holding company. These actions show that the management of IDSM did not act bona fide in the interest of the company as a whole and that they acted for a collateral purpose. IDSM was stripped of all its physical assets and its trade receivables and the ultimate beneficiary of these actions was the holding company. In the circumstances the business of IDSM had been carried out with intent to defraud customers within s 304(1) of the Act (see para 26).

(4) The first and second defendants were not a party to the carrying out of business of IDSM with 'intent to defraud creditors' within the meaning of s 304(1) of the Act as it was clear that throughout the period in question the management of IDSM was in the control of the third and fourth defendants. The 'statement by directors' in the 2004 audited accounts was made by the third and fourth defendants while the fourth defendant made the statutory declaration that he was the director primarily responsible for the accounting records and financial management of IDSM. As such the entire business was managed and controlled by the third and fourth defendants as directors of IDSM and they acted knowingly in the service of the holding company. Thus the

third and fourth defendants were personally liable, jointly and severally to the plaintiff for the judgment debt of US90,858.01 (see paras 27 & 28(b)).

[Bahasa Malaysia summary

Pada 2003, IDSM Sdn Bhd ('IDSM'), defendan kelima telah membeli dan menerima penghantaran komponen-komponen elektrik ('barangan tersebut') daripada plaintif syarikat. Apabila IDSM tidak membayar bagi barangan tersebut, plaintif memulakan tindakan undang-undang terhadap IDSM bagi harga barangan tersebut, yang berjumlah US$90,585.01. Dalam pembelaannya, IDSM menyatakan bahawa barangan tersebut cacat dan kualitinya tak boleh niaga dan menuntut balas untuk ganti rugi. Walau bagaimanapun, dalam 2006 IDSM mengabaikan pembelaan dan tuntutan balasnya manakala plaintif mendapat penghakiman terhadap IDSM atas tuntutannya. Plaintif kini mendakwa bahawa semasa tindakan sivil terhadap IDSM, defendan-defendan pertama, kedua, ketiga dan keempat sebagai pengarah-pengarah dan/atau pemegang-pemegang saham IDSM, bersalahan dari segi undang-undang, telah melesapkan aset-aset dan wang IDSM dan menyebabkan plaintif hanya memperoleh penghakiman atas kertas sahaja, kerana IDSM tiada aset untuk membayar jumlah penghakiman apabila penghakiman diberikan kepada plaintif pada 4 Januari 2006. Oleh itu, plaintif memulakan tindakan ini terhadap keempat-empat pengarah dan/atau pemegang saham IDSM dan memohon pengisytiharan bahawa defendan pertama hingga keempat bertanggungan secara peribadi, secara bersesama dan/atau berasingan kepada plaintif bagi jumlah penghakiman sebanyak US$90,585.01, yang kena bayar oleh IDSM kepada plaintif dan perintah-perintah berbangkit. Untuk menyokong tuntutannya berdasarkan s 304(1) Akta Syarikat 1965 ('Akta') plaintif menjejaki peristiwa-peristiwa yang berlaku pada tahun 2003 dan 2004, iaitu, bagaimana IDSM memperkecilkan saiz operasinya pada tahun 2003 dengan menjual dua unit rumah kedai dan mengurangkan tenaga kerja, memindahkan kesemua aset fizikal IDSM kepada China Enersave Ltd ('syarikat pegangan'), syarikat pegangannya di Singapura, menerusi surat ikatan serahhak memindahkan perdagangan terimanya berjumlah RM3 juta kepada syarikat pegangan tersebut tanpa balasan, menghapuskan stok-stoknya, loji dan peralatan, mesin dan perdagangan terima sebelum menamatkan operasinya pada Disember 2004. Semasa perbicaraan, juruaudit yang mengaudit akaun-akaun IDSM dalam 2004 yang telah diaudit gagal mengesahkan bahawa akaun-akaun yang telah diauditkan tersebut memberi gambaran sebenar dan wajar tentang hal ehwal IDSM. Juruaudit juga memberi keterangan bahawa adalah tidak wajar dan salah menghapuskan stok-stoknya kepada nilai kosong tanpa dokumen-dokumen sokongan yang mencukupi dan memindahkan perdagangan terima IDSM kepada syarikat pegangan dengan cara surat

ikatan serahhak. Dalam pembelaannya, kedua-dua defendan pertama dan kedua menafikan sebarang pengetahuan tentang pemindahan aset-aset fizikal IDSM dan sebarang pembabitannya dalam surat ikatan serahhak tersebut. Keterangan menunjukkan bahawa defendan pertama telah meletak jwatan sebagai pengarah sebelum tarikh penyempurnaan surat ikatan serahhak tersebut dan defendan kedua tidak tahu menahu tentang surat ikatan serahhak tersebut. Defendan pertama dan kedua juga memplid bahawa sebagai pemegang saham minoriti mereka tidak membuat keputusan dalam IDSM. Defendan ketiga dan keempat merupakan pengarah-pengarah syarikat pegangan tersebut yang dilantik oleh syarikat pegangan tersebut untuk menjadi pengarah-pengarah IDSM pada masa yang material. Defendan ketiga juga mengakui bahawa dia dan defendan keempat telah memberi kebenaran atas surat ikatan serahhak tersebut untuk memindahkan perdagangan terima tersebut kepada syarikat pegangan tersebut tetapi menafikan melupuskan loji, peralatan dan mesin. Dalam pembelaannya defendan ketiga dan keempat menyatakan bahawa mereka menjalankan perlaksanaan korporat yang biasa apabila menjual aset-aset dan mengurangkan tenaga kerjanya pada 2004 untuk mengurangkan kos, dan bahawa kesemua tindakan ini dilakukan sebelum plaintif mendapat penghakiman terhadap IDSM dalam tahun 2006, dan oleh itu tindakan-tindakan ini tidak boleh dikatakan bertujuan memfraud plaintif. Selanjutnya mereka menyatakan bahawa memandangkan mereka pengarah-pengarah penama, tidak ada asas bagi plaintif menuntut terhadap mereka di bawah s 304(1) Akta. Isu-isu utama yang perlu dipertimbangkan dalam kes ini ialah sama ada IDSM telah melaksanakan perniagaannya dalam makna s 304(1) Akta dan sama ada perniagaan IDSM telah dijalankan dengan niat untuk memfraud pemiutang-pemiutang atau untuk sebarang tujuan memfraud. Jika isu-isu tersebut dijawab positif maka adalah perlu untuk mempertimbangkan sama ada mana-mana satu atau lebih daripada defendan-defendan merupakan pihak yang sedia maklum tentang IDSM menjalankan perniagaan sepertimana yang dijalankannya.

Diputuskan, menolak tuntutan terhadap defendan pertama dan kedua dengan kos dan defendan ketiga dan keempat bertanggungan secara persendiriannya, bersesama dan berasingan terhadap plaintif dengan faedah dan kos:

(1) Ayat 'any business of the company has been carried out …' dalam s 304(1) Akta ditafsirkan merangkumi pelbagai aktiviti dan transaksi yang dijalankan oleh sebuah syarikat. Akaun-akaun IDSM 2003 yang telah diaudit menunjukkan pendapatan sebanyak RM6,860,094 tetapi laporan juruaudit terhadap akaun-akaun 2004 yang telah diaudit menunjukkan bahawa IDSM telah menamatkan opersinya pada Disember 2004. Daripada fakta ini, adalah didapati bahawa IDSM

telah menjalankan perniagaannya menurut maksud 304(1) dalam tempoh masa dari 1 Januari 2003 hingga 31 Disember 2004 (lihat perenggan 19).

(2) Ayat 'with intent to defraud creditors … or for any fraudulent purpose' dalam s 304(1) harus dibaca secara berasingan walaupun atas fakta-fakta kes, kedua-dua bahagian adalah relevan dan boleh digunapakai. Tanpa mengambilkira perkataan 'creditors' dalam s 304(1), tidak penting bahawa hanya satu pemiutang yang difraudkan dan ia hanya difraudkan dengan satu transaksi. Sama ada wujudnya niat untuk memfraud di pihak defendan-defendan merupakan persoalan fakta yang perlu disimpulkan daripada keadaan-keadaan dan perilaku-perilaku kemudian defendan-defendan. Dalam kes ini juruaudit secara kategorinya telah menyatakan bahawa akaun-akaun tersebut tidak dibuat dengan betul menurut peruntukan-peruntukan Akta dan standard perakaunan di Malaysia. Berkenaan isu ini, terdapat keabaian tugas di pihak pengarah-pengarah IDSM dan tiada dalam nota-nota akaun-akaun yang menjelaskan mengapa akaun keuntungan dan kerugian tidak dibuat menurut standard perakaunan yang diluluskan (lihat perenggan 21 & 24).

(3) Adalah jelas bahawa apabila IDSM membeli komponen-komponen elektrik daripada plaintif pengarah-pengarah IDSM sedia maklum bahawa tiada kemungkinan yang plaintif akan menerima bayaran bagi harga belian tersebut. Selanjutnya, walaupun IDSM mempunyai perdagangan terima substansial berlebihan sebanyak RM4 juta, IDSM telah berkeputusan untuk melupuskan perdagangan terima tersebut sebagai hutang-hutang ragu sedangkan sebanyak RM3 juta telah dipindahkan kepada syarikat pegangan. Tindakan ini menunjukkan bahawa pengurusan IDSM tidak bertindak secara bona fide untuk kepentingan syarikat keseluruhannya dan bahawa mereka bertindak untuk tujuan kolateral. IDSM telah dilupuskan kesemua aset fizikalnya dan dagangan terimanya dan benefisiari utama atas tindakan-tindakan ini merupakan syarikat pegangan tersebut. Dalam keadaan-keadaan ini, perniagaan IDSM telah dijalankan tanpa niat untuk memfraud pelanggan-pelanggan seperti tafsiran s 304(1) Akta (lihat perenggan 26).

(4) Defendan pertama dan kedua bukanlah pihak-pihak yang melaksanakan perniagaan IDSM dengan 'intent to defraud creditors' sepertimana tafsiran s 304(1) Akta kerana adalah jelas bahawa sepanjang tempoh yang menjadi persoalan, pihak pengurusan IDSM yang mengawal defendan ketiga dan keempat. 'Statement by Directors' dalam akaun-akaun yang telah diaudit pada tahun 2004 dibuat oleh defendan ketiga dan keempat sedangkan defendan keempat membuat perisytiharan statutori bahawa dia merupakan pengarah yang

bertanggungjawab sepenuhnya bagi rekod-rekod perakaunan dan pengurusan kewangan IDSM. Oleh itu, keseluruhan perniagaan diurus dan dikawal oleh defendan-defendan ketiga dan keempat sebagai pengarah-pengarah IDSM dan mereka bertindak dengan pengetahuan, berkhidmat kepada syarikat pegangan tersebut. Oleh itu, defendan ketiga dan keempat bertanggungan secara persendirian, bersesama dan berasingan terhadap plaintif untuk hutang penghakiman US$90,858.01 (lihat perenggan 27 & 28(b)).]

Notes

For cases on personal liability, see 3(1) *Mallal's Digest* (4th Ed, 2006 Reissue) paras 312–317.

Cases referred to

Augustus Barnett & Sons Ltd, Re [1986] BCLC 170, Ch D (refd)
Caparo Industries plc v Dickman & Ors [1990] 1 All ER 568, HL (refd)
Coleman v The Queen (1987) 5 ACLC 766, CA (refd)
FP & CH Matthews Ltd, Re [1982] 1 All ER 338, CA (refd)
Gerald Cooper Chemicals Ltd, Re [1978] 2 All ER 49, Ch D (refd)
H Rosen Engineering BV v Siow Yoon Keong [1997] 1 CLJ 137, HC (refd)
Maidstone Buildings Provisions Ltd, Re [1971] 3 All ER 363, Ch D (refd)
Patrick & Lyon Ltd, Re [1933] Ch 786, Ch D (refd)
PJTV Denson (M) Sdn Bhd & Ors v Roxy (M) Sdn Bhd [1980] 2 MLJ 136, FC (refd)
R v Grantham [1984] 3 All ER 166, CA (refd)
Rahj Kamal bin Abdullah v PP [1998] 1 SLR 447, HC (refd)
Sarflax Ltd, Re [1979] 2 WLR 202, Ch D (refd)
Siow Yoon Keong v H Rosen Engineering BV [2003] 4 MLJ 569; [2003] 5 AMR 735, CA (refd)
Ting Ling Kiew & Anor v Tang Eng Iron Works Co Ltd [1992] 2 MLJ 217; [1992] 3 CLJ 1685, SC (refd)
William C Leitch Bros Ltd (No 1), Re [1932] 2 Ch 71, Ch D (refd)
Winkworth v Edward Baron Development Co Ltd & Ors [1987] 1 All ER 114, HL (refd)

Legislation referred to

Companies Act 1965 ss 166A(3), (5), 169, 169(1), (3), (14), 174(3)(a), (b), 304, 304(1), 305

CM Yeo (CM Yeo & Associates) for the plaintiff.
Susan Yeap (The Law Chambers of Yeap & Lim) for the first and second defendants.
Russell Lua Kok Hiyong (Patricia Chan with him) (Lua & Mansor) for the third and fourth defendants.

Vernon Ong JC:

[1] On 4 January 2006 the plaintiff obtained judgment against IDSM Sdn Bhd ('IDSM') for US$90,585.01 on a trade debt for electronic components sold and delivered by the plaintiff to IDSM. The plaintiff claims that the assets and funds of IDSM were unlawfully dissipated by the first, second, third and fourth defendants as directors and/or shareholders of IDSM. The plaintiff is seeking a declaration that the first, second, third and fourth defendants as directors of IDSM are personally liable, jointly and/or severally, to the plaintiff for the judgment debt of US$90,585.01 due and owing by IDSM to the plaintiff and other consequential orders.

THE FACTS

[2] The salient facts as presented by the evidence are as follows:

(a) Between 12 May 2003 to 14 November 2003 the plaintiff sold and supplied electronic components to IDSM. IDSM failed to pay the purchase price of the goods amounting to US$90,58501. On 5 March 2004 the plaintiff filed a civil suit at the Johor Bahru High Court under Civil Suit No 22–190 of 2004 ('2004 action') against IDSM claiming the sum of US$90,585.01. IDSM filed a defence and counterclaim for US$26,356.39.

(b) In 2004 all of the physical assets of IDSM including its stocks, plant, equipment and machinery were transferred to its holding company ('China Enersave Ltd') in Singapore.

(c) In 2004 IDSM wrote off all of its physical assets including its stocks, plant, equipment and machinery costing RM1,462,036.

(d) The third and fourth defendants signed a board resolution dated 29 October 2004 authorising the fourth defendant to sign a deed of assignment for the transfer of trade receivables of US$794,000 (due to IDSM from its trade debtor Perle Systems Ltd) to China Enersave Ltd.

(e) By a deed of assignment dated 31 October 2004 ('deed of assignment') IDSM transferred the said trade receivables to China Enersave Ltd.

(f) IDSM's reports and financial statements as at 31 December 2004 ('2004 audited accounts') was qualified by its auditor in the following manner:

A We would like to draw your attention to the followings (sic):

(1) the company ceased operation in December, 2004 and during the financial year, the company has significantly written off its physical and tangible assets;

B (2) the company made a provision for stocks of RM2,106,859 comprising mainly raw materials which the company has claimed to be obsolete, damaged and of little resale values;

(3) plant and equipment with net book values of RM308,189 were written off on the ground of their non-functional condition and little disposal value. Included in the written-off plant and equipment are machinery costing RM1,462.036 and accumulated depreciation of RM1,417,179 as at years end;

C

D (4) the company made a provision for all its debts existing at year end amounting to RM4,527,688. Certain legal actions had been taken against the trade sum of RM1,050,453; and

(5) the company's financial performance was in significant loss position for the current and previous financial years.

E *In view of the significance of the matters discussed in the preceding paragraphs, we are unable to form any opinion as to whether the financial statements have been properly drawn up in accordance with the provisions of the Companies Act 1965 and approved accounting standards in Malaysia so as to give a true and fair view of*:

F (i) *the state of affairs of the company as at 31 December 2004 and of the results and cash flows of the company for the financial year ended; and*

(ii) *the matters required by s 169 of the Companies Act 1965 to be dealt with in the financial statements*. (Emphasis added.)

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(g) On 4 January 2006 the plaintiff entered judgment against IDSM for US$90,585.01 in the 2004 action after IDSM abandoned its defence and counterclaim.

H (h) The first and second defendants are directors and shareholders of IDSM; the first defendant resigned as director on 1 June 2004.

(i) The third and fourth defendants are directors of IDSM.

(j) The third defendant is also a director of China Enersave Ltd.

I (k) The fourth defendant is an executive director and shareholder of China Enersave Ltd.

(l) The holding and ultimate holding company or companies of IDSM according to IDSM audited accounts (a) as at 31 December 2003 are

China Enersave Ltd and ACMA Ltd; and (b) as at 31 December 2004 is China Enersave Ltd.

THE PLAINTIFF'S CASE

[3] The plaintiff's claim is predicated on s 304(1) of the Companies Act 1965 ('the Act'). It is contended that during the subsistence of the 2004 action the first, second, third and fourth defendants, as directors and/or shareholders of IDSM unlawfully dissipated the assets and funds of IDSM. Firstly, they unlawfully wrote-off all its stocks valued at RM3,229,969 as at 31 December 2003 and all its plant, equipment and machinery (costing RM1,530,115 with a book value of RM405,417 as at 31 December 2003) Secondly, they unlawfully transferred all the physical assets of IDSM including all its stocks ('inventories'), plant, equipment and machinery to China Enersave Ltd, in Singapore for which China Enersave Ltd did not give any consideration. Thirdly, they unlawfully transferred and/or assigned the trade receivables of IDSM amounting to US$794,000 (due and owing from its trade debtor Perle Systems Ltd) to China Enersave Ltd; rendering China Enersave Ltd indebted to IDSM the equivalent sum of US$794,000. Fourthly, the resulting debt of US$794,000 was also wholly written-off by IDSM which resulted in China Enersave Ltd receiving the benefit of the trade receivables without any consideration whatsoever. The assignment of the trade debt was without any corporate purpose or commercial benefit to IDSM. The third and fourth defendant's resigned as directors of IDSM on 1 January 2006. Three days later, on 4 January 2006 IDSM abandoned its defence and counterclaim in the 2004 action allowing the plaintiff to obtain a paper judgment against IDSM. As a consequence of the aforesaid actions IDSM was left with no assets or funds to pay the debt owed to the plaintiff by the time the judgment was obtained on 4 January 2006.

THE EVIDENCE

[4] Mr Kuan Cheng Toon (PW2) is an audit partner of the firm which audited IDSM's 2004 audited accounts. PW2 qualified the 2004 audited accounts because he was unable to form a professional opinion as to whether the said accounts had been properly drawn up in accordance with the provisions of the Act and approved accounting standards. PW2 was unable to verify that the 2004 audited accounts gives a true and fair view of the affairs of IDSM. In particular, PW2 said that IDSM had written-off (i) stocks totalling RM2,106,859 claiming all stocks to be obsolete, damaged and of little resale value; and (ii) plant and equipment, other than machinery, with a net book value of RM308,189 claiming the same to be in a non-functional condition and of little disposal value and machinery costing RM1,462,036. IDSM did not allow PW2's staff or an independent valuer to inspect and

verify both claims. In both instances, PW2 said that 'it is not justifiable and convincing in audit aspect to wholly write off the significant amount of the stocks to zero value without obtaining appropriate and sufficient supporting evidence and documents'. PW2 also said that IDSM had made provision to write-off the whole of its trade receivables amounting to RM4,527,688 claiming the same to be doubtful debts although RM3,017,200 of the trade receivables due from Perle Systems Ltd were to be paid pursuant to a debt settlement agreement entered on 15 September 2003; and the said RM3,017,200 was assigned to China Enersave Ltd under the deed of assignment. PW2 said that in view of the debt settlement agreement and the deed of assignment the write-off of the RM3,017,200 trade receivables is unjustifiable and incorrect.

[5] The first defendant testified that he resigned as a managing director of IDSM on 1 June 2004 but remained as a shareholder. In 2003 IDSM was incurring losses and the board of directors decided to downsize by reducing manpower and disposing off two units of shop houses. The shareholders of IDSM also decided to shift the equipments and raw materials to Singapore. He said that the said transactions were commercial decisions by the majority of the shareholders. All the decisions made by IDSM were in fact made by China Enersave Ltd. He did not have any personal knowledge of the deed of assignment. Under cross-examination he said that he did not object when the plant, equipment and machinery and inventory and material were moved to China Enersave Ltd for zero consideration because he was not aware of the zero consideration. He was not aware of the assignment of the trade receivables of RM3m to China Enersave. He denied the suggestion that as managing director of IDSM until 1 June 2004 and as shareholder he stood by and allowed IDSM's assets and funds to be dissipated to China Enersave Ltd. He admitted that he was aware that IDSM had trade debts at the material time.

[6] The second defendant is a director and shareholder of the first defendant company. He said that back then the company secretary called him asking him to go to her office to sign a resolution. He cannot remember asking her what the resolution was about and he did not take the trouble to see the company secretary and she never called him again after that. He said that he did not have any personal knowledge of the deed of assignment. The second defendant said that all decisions made by IDSM was in fact made by China Enersave Ltd. In cross-examination he agreed that the transfer of the RM3m trade debt to China Enersave Ltd is wrong. He also agreed that there is no reason whatsoever for IDSM to transfer the trade receivables to China Enersave Ltd. He testified that he did not know the purpose for the assignment of the RM3m trade receivables to China Enersave Ltd. He did not sign the resolution. He also said that IDSM's assets were moved to China

Enersave Ltd or their related company. The second defendant was aware that IDSM was shutting down in 2003 because they had already sold off the factory. The second defendant also admitted that he was aware that IDSM had trade debts at the material time.

[7] The third defendant is a director of China Enersave Ltd. He testified that at all material times he was a director of IDSM; he was nominated as a director by China Enersave Ltd to look after its interests. He agreed that he had an indirect interest in IDSM through his share purchase option in China Enersave Ltd. He admitted signing the 2004 audited accounts; he also admitted signing the deed of assignment. The third defendant agreed that China Enersave Ltd owed IDSM RM531,820 as at 31 December 2003. Under cross-examination he disagreed with the suggestion that there is no reason for the said assignment. However, he agreed that there were no reasons given for the assignment. The third defendant was unable to confirm whether all the plant, equipment and machinery, inventory and raw materials were moved to China Enersave Ltd. He also said that China Enersave Ltd divested its majority shares in IDSM on 28 October 2004 so that as at 31 December 2004 China Enersave Ltd did not hold any shares in IDSM. However, he agreed that according to the 2004 audited accounts China Enersave Ltd is still regarded as a holding company. One day after China Enersave Ltd announced its divestment of its shares IDSM passed a resolution to assign the RM3m trade receivables to China Enersave Ltd. The deed of assignment for the trade receivables was signed three days after that. The third defendant admitted that the resolution for the assignment of the trade receivables and the deed of assignment was not disclosed in the 2004 audited accounts of China Enersave Ltd. He agreed that he and the fourth defendant authorised the deed of assignment but denied authorising writing-off the plant, equipment, machinery, inventory and raw materials. He also agreed that both he and the fourth defendant were the management of IDSM at that time. Even though China Enersave Ltd no longer held shares in IDSM the third defendant remained as a director until 1 January 2006.

[8] The fourth defendant testified that he is the executive director of China Enersave Ltd and that he was appointed as a director of IDSM as China Enersave Ltd's corporate representative. He confirmed that he is a shareholder of China Enersave Ltd. He said that the 2004 audited accounts stating the China Enersave Ltd is its holding company is not true. He also disagreed with the suggestion that this representation was so that China Enersave Ltd could avoid disclosing and explaining the subsequent transfer of ISDM Electronics' funds and substantial assets (which have been written-off) to China Enersave Ltd. The fourth defendant said that he was involved in the key decision making process of the board of directors of IDSM at all material times, but he denied being involved in the management. He admitted signing the

resolution and deed of assignment. He denied the suggestion that there is no corporate purpose for the transfer of funds. He also claimed to have no personal knowledge of the transfer of the plant, equipment, machinery, inventories and raw materials to China Enersave Ltd.

[9] Mr Koo Ah Seang (DW5) the chief executive officer of China Enersave Ltd denied that any of the IDSM directors had ever traded with intent to defraud the plaintiff. He said that at the material time IDSM was still solvent.

THE FIRST AND SECOND DEFENDANTS' DEFENCE

[10] The second defendant did not sign the resolution on 29 October 2004 authorising the deed of assignment of the trade debt of RM3m because he was not informed of it. On that date the first defendant was no longer a director and he had no knowledge of the matter. The second defendant only became aware of this transaction after the 2004 action had been instituted.

[11] There was nothing to show that there is any intent to defraud or any fraudulent purpose. The first and second defendants denied any involvement in the deed of assignment. The first defendant had resigned as a director prior to the date of the execution of the deed of assignment and the second defendant was not made aware of the existence of the same.

[12] As minority shareholders the first and second defendants are not the decision makers in IDSM. The decision to remove IDSM's plant, equipment, machinery, inventories and raw materials to China Enersave Ltd in Singapore was made by the majority shareholder and not by the minority shareholders. Even if they had objected to it, the majority will prevail. At any rate both the first and second defendant denied any knowledge of the same.

[13] The downsizing of IDSM was morally acceptable by the commercial world as a way to salvage a company which was suffering from huge losses and the first and second defendants did not make any personal gains from it (*H Rosen Engineering BV v Siow Yoon Keong* [1997] 1 CLJ 137; *Ting Ling Kiew & Anor v Tang Eng Iron Works Co Ltd* [1992] 2 MLJ 217; [1992] 3 CLJ 1685). From the evidence tendered in court the first and second defendants did not have the fraudulent intent and neither did they carry out any fraudulent act.

THE THIRD AND FOURTH DEFENDANTS' DEFENCE

[14] Learned counsel submitted that the plaintiff's claim should have been brought under s 305 of the Act for misfeasance or breach of trust or duty as

directors of IDSM. In an action under s 304 of the Act the plaintiff must establish that a person must have taken positive steps, merely inertia was not enough in the fraudulent trading (*Re Maidstone Buildings Provisions Ltd* [1971] 3 All ER 363). There was no evidence to show that the third and fourth defendants were involved in the trading or running of business of IDSM. IDSM was not bound to pay off every debt as soon as it is incurred. When the plaintiff filed a suit against IDSM in 2004 the suit was properly defended (*Winkworth v Edward Baron Development Co Ltd & Ors* [1987] 1 All ER 114). The mere fact that IDSM's solicitors did not appear in case management does not mean that they filed a sham defence and counterclaim. In 2003 when IDSM was trading with the plaintiff IDSM was solvent. The directors only owe duties to creditors when the company is insolvent. When a company is solvent the directors owe its duties to the shareholders of the company.

[15] It was also contended that PW3 did not meet up with the directors or former director of IDSM before qualifying the financial statements. There is no evidence to show that IDSM when carrying out the normal corporate exercise to cut losses by selling assets, reducing workers in 2004 before the judgment was entered in 2006 can be said to have intended to defraud the plaintiff. The decision of a company to cut losses and carry out any corporate exercise to prolong its survival are matters to be decided by the board of directors and not by the court (*Company Law* (2nd Ed) Walter Woon at p 274). The decision to downsize, cut losses, etc by IDSM in 2004 was based on the poor performance of IDSM and the decision of China Enersave Ltd to sell its shares in good faith; all of which are within the discretion of the management.

[16] Finally it was submitted that since the third and fourth defendants are nominee directors there is no basis for the plaintiff to claim against them for fraudulent trading. They were not knowingly party to the business conducted in 2003. The second defendant admitted the third and fourth defendants did not know about IDSM's IPO office in Singapore. Therefore they did not have any knowledge of the 44 deliveries made by the plaintiff to IDSM's Singapore office in 2003. Without any personal knowledge they cannot be held liable for the trade debt of IDSM. Section 304 of the Act requires that the person concerned should be a party to the carrying on of the business in fraudulent manner (*Re Maidstone Buildings Provisions Ltd*).

FINDINGS OF THE COURT

[17] The plaintiff's claim is predicated on s 304 of the Act. Section 304(1) provides as that:

> If in the course of the winding-up of a company or in any proceedings against a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or any fraudulent purpose, the Court on the application of the liquidator or any creditor or contributory of the company may if it thinks proper so to do declare that any person who was knowingly a party to the carrying on of the business in that manner shall be personally responsible, without any limitation of liability, for all of any of the debts or other liabilities of the company as the Court directs.

[18] The issue before the court falls upon the interpretation of s 304(1) and whether the facts of this case falls within the meaning of that subsection. The wording of the section is quite clear. It is only necessary to establish that there was an intention to defraud. The standard of proof required is a lower degree of proof by reason of the words 'if it appears' in s 304(1). It is therefore sufficient if on the evidence before the court it appears that the business of IDSM has been conducted with intent to defraud creditors or for any other fraudulent purpose.

FIRST ISSUE

[19] The first issue to be determined is whether IDSM carried out business within the meaning of s 304(1). The words 'any business of the company has been carried out ...' has been interpreted in a number of cases to include (i) in a criminal case, the obtaining of credit for the company (*R v Grantham* [1984] 3 All ER 166); (ii) providing letters of comfort to a subsidiary even though on the facts if that case was held not to be fraudulent (*Re Augustus Barnett & Son Ltd* [1986] BCLC 170); (iii) the collection of assets acquired in the course of business and distribution of proceeds thereof in payment of debts (*Re Sarflax Ltd* [1979] 2 WLR 202); and payment of two cheques into the company current account with the bank thereby clearing the company's overdraft (*Re FP & CH Matthews Ltd* [1982] 1 All ER 338). The said words have been interpreted to include a myriad of activities and transactions undertaken by a company. In 2003 IDSM purchased electronic components from the plaintiff. IDSM's defence in the 2004 action is premised on the ground the electronic components were purchased from the plaintiff. It was only contended that the electronic components were defective and not of merchantable quality. IDSM's 2003 audited accounts showed an income revenue of RM6,860,094. However, as stated in the auditor's report to the 2004 audited accounts IDSM ceased operation in December 2004. On these facts, the court finds that during the period from 1 January 2003 to 31 December 2004 the business of IDSM has been carried out.

SECOND ISSUE

[20] The second issue to be determined is whether the business of IDSM

has been carried on 'with intent to defraud creditors ... or for any fraudulent purpose' within the meaning of s 304(1)? What is an intent to defraud? It is an intent to deprive creditors, or some creditors, of an economic advantage or inflict upon them some economic loss (*Coleman v The Queen* (1987) 5 ACLC 766. What is fraud? The existence of fraud is a question of fact. It is dependent upon the circumstances of each particular case as stated by the Federal Court in *PJTV Denson (M) Sdn Bhd & Ors v Roxy (M) Sdn Bhd* [1980] 2 MLJ 136. Raja Azlan Shah CJ (Malaya) (as HRH then was) said at p 138:

> Whether fraud exists is a question of fact, to be decided upon the circumstances of each particular case. Decided cases are only illustrative of fraud. Fraud must mean 'actual fraud, ie dishonesty of some sort' for which the registered proprietor is a party or privy. 'Fraud is the same in all courts, but such expressions as 'constructive fraud' are ... inaccurate;' but 'fraud'... implies a wilful act, on the part of one, whereby another is sought to be deprived, by unjustifiable means, of which he is entitled' (per Romilly MR in *Green v Nixon*). Thus in *Waimiha Sawmilling Co Ltd v Waione Timber Co Ltd*, it was said that 'if the designed object of a transfer be to cheat a man of a known existing right, that is fraudulent ...'

[21] The words 'with intent to defraud creditors ... or for any fraudulent purpose' of s 304(1) should be read disjunctively even though on the facts of the case both limbs are relevant and applicable (*Siow Yoon Keong v H Rosen Engineering BV* [2003] 4 MLJ 569; [2003] 5 AMR 735 (CA)). The said words has been interpreted in a number of cases to include (i) a situation where a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts (*Re William C Leitch Bros Ltd (No 1)* [1932] 2 Ch 71); (ii) that fraud in the context of fraudulent trading constitutes 'actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame' (*Re Patrick & Lyon Ltd* [1933] Ch 786 at p 790); (iii) where a person who takes part in the management of a company's affairs obtains credit or further credit for the company when he knows that there is no reason for thinking that funds will become available to pay the debts when it becomes due or shortly thereafter (*R v Grantham*); (iv) where a company accepted the purchase price in advance knowing that it would not supply the goods and would not repay the advance paid (In *Re Gerald Cooper Chemicals Ltd*); and (v) a person was knowingly party to the business of a company having been carried out with intent to defraud creditors if at the time when debts were incurred by the company he had no good reason for thinking that funds would be available to pay those debts when they became due or shortly thereafter and there was dishonesty involving real moral blame according to current notions of fair trading (in a company (No 01418 of 1988) [1991] BCLC 198). Notwithstanding the word 'creditors' in s 304(1), for the purpose of s 304(1) it does not matter

that only one creditor was defrauded and that he was defrauded by one transaction, provided that the transaction could properly be described as a fraud on a creditor perpetuated in the course of carrying on business (*Siow Yoon Keong v H Rosen Engineering BV*; *Re Gerald Cooper Chemicals Ltd* [1978] 2 All ER 49). Whether there was any intention on the part of the defendant' to defraud or to carry out any fraudulent purpose is a question of fact to be inferred from the surrounding circumstances and the subsequent conduct of the defendant, especially the concealment of material facts (*Rahj Kamal bin Abdullah v Public Prosecutor* [1998] 1 SLR 447).

[22] In 2003 IDSM purchased and took delivery of electronic components from the plaintiff. IDSM did not pay for the same resulting in the plaintiff instituting legal action against IDSM for US$90,585.01 in the 2004 action. IDSM contended that the electronic components were defective and not of merchantable quality and counterclaimed for damages. However, in 2006 IDSM abandoned its defence and counterclaim whereupon the plaintiff obtained judgment against IDSM on its claim. In this connection it is important to trace the following events which took place in 2003 and 2004:

(a) In 2003 IDSM was suffering losses. IDSM was downsizing. IDSM had sold off two units of shop houses and cut down on manpower;

(b) In 2004 all of IDSM physical assets (plant, equipment, machinery, stocks and raw materials) were shifted to China Enersave Ltd. No consideration was given by China Enersave Ltd to IDSM for the physical assets.

(c) In 2004 IDSM transferred its trade receivables of RM3,017,200 to China Enersave Ltd for no consideration.

(d) In 2004 IDSM wrote-off (i) stocks of RM2,106,859 comprising of raw materials worth RM1,948,777; (ii) plant and equipment worth RM308,189.99 and machinery worth RM1,462.036; and (iii) trade receivables amounting to RM4,527,688.

(e) IDSM ceased operations in December 2004.

[23] The aforesaid events when examined in the light of the auditor's comments and evidence are particularly significant. IDSM's auditor ('PW3') was unable to confirm that the 2004 audited accounts had been properly drawn up in accordance with the provisions of the Act and approved accounting standards in Malaysia. PW3 was also unable to verify that the 2004 audited accounts gives a true and fair view of the state of affairs of IDSM as at 31 December 2004 and of the results and cash flows of IDSM and of the matters required under s 169 of the Act. PW3 explained that (i) the writing-off of the RM2,106,859 worth of stocks is not justifiable and convincing in the absence of proper and sufficient supporting evidence and

documents; and (ii) the writing-off of the plant, equipment (RM308,189) and machinery (RM1,462,036) is unjustifiable and convincing because the plant, equipment and machinery were still able to produce goods to generate a revenue of more than RM6m in 2003 and RM230,000 in 2004. In both cases IDSM did not allow the auditor or an independent valuer to inspect and verify the claims. Equally significant are PW3's comments on the writing-off of IDSM's trade receivables of RM4,527,688 as doubtful debts. PW3 explained that this provision to write-off RM4,527,688 is also questionable, unjustifiable and incorrect because RM3,017,200 of the trade receivables from Perle Systems Ltd were to be paid under a debt settlement agreement dated 15 September 2003 but it had been transferred to China Enersave Ltd under the deed of assignment.

[24] Under sub-s (1) and (3) of s 169 of the Act the directors of a company are under a duty to lay before the company in general meeting a profit and loss accounts and a balance sheet which have been duly audited. The directors are obliged by law to ensure that the accounts of the company are made up in accordance with approved accounting standards (s 166A(3)). In this case the auditor has categorically stated that the accounts have not been properly drawn up in accordance with the provisions of the Act and approved accounting standards in Malaysia. It implies that the profit and loss accounts does not give a true and fair view of the profit and loss of IDSM. In such an event it is the duty of IDSM's directors to (i) disclose by way of a note on the accounts their reason for not making the accounts in accordance with the approved accounting standards; and (ii) give particulars in the notes of the quantified financial effect on the accounts if the relevant accounting standards was complied with (s 166A(5)). On this issue the court finds that there is dereliction of duty on the part of IDSM's directors as there is nothing in the notes to the accounts explaining why the profit and loss accounts was not made out in accordance with approved accounting standards. The auditor was also unable to verify that the 2004 audited accounts gives a true and fair view of the state of affairs of IDSM. This further implies that the balance sheet does not give a true and fair view of the state of affairs of the company (s 169(14) of the Act).

[25] These aforesaid comments coming from IDSM's own auditors are very telling. It is an indictment against the management of IDSM. It is the statutory duty of the auditor to examine the accounting records and other records and registers kept by IDSM as required under the Act and to form an opinion as to whether the auditor has obtained all the information and explanations that are required (s 174(3)(a) and (b)). It is pertinent to note that the auditor is duty bound to be independent so as to ensure that the shareholders in the general meeting receives an unbiased opinion on the true and fair view of the company's position. The function of an auditor has been

succinctly described by Lord Oliver in *Caparo Industries plc v Dickman & Ors* [1990] 1 All ER 568 at p 583 (HL) as:

> It is the auditor's function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order, first to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital) and, second, to provide shareholders with reliable intelligence for the purposes of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided.

[26] It is clear that in 2003 when IDSM purchased the electronic components from the plaintiff the directors of IDSM must have known that there was no reasonable prospect of the plaintiff ever receiving payment for the purchase price. By then IDSM was already downsizing its operations. There was no reason for the directors to think that funds will become available to settle the purchase price. In 2003 manpower was being reduced and some of the assets of IDSM were disposed off. In 2004 practically all of IDSM's physical assets and stocks were written-off in the accounts and shipped to its holding company China Enersave Ltd in Singapore. Notwithstanding that IDSM had substantial trade receivables in excess of RM4m, IDSM also decided to write-off the same as doubtful debts; when in fact the so-called doubtful debt of RM3m had been diverted to China Enersave Ltd. The actions aforesaid show that the management of IDSM did not act bona fide in the interest of the company as a whole; they did not act honestly. Instead they acted for a collateral purpose. IDSM was stripped of all its physical assets and its trade receivables. The ultimate beneficiary of these actions is China Enersave Ltd, the holding company. The actions are not consistent with current notions of fair trading. It is deceitful and unethical. It has been explicitly condemned by IDSM's own auditor. In the circumstances the court has no hesitation in finding that the business of IDSM appears to have been carried out with intent to defraud creditors within the meaning of s 304(1).

THIRD ISSUE

[27] The third issue to be determined is whether any one of more of the defendants was knowingly a party to the carrying on of the business in that manner. The first, second, third and fourth defendants were directors of IDSM when the goods were purchased from the plaintiff in 2003. The first defendant resigned as director on 1 June 2004. Both the first and second defendants said that all the decisions of IDSM were made by China Enersave Ltd through its nominee directors the third and fourth defendants. The third and fourth defendants signed the 2004 audited accounts thereby asserting

that it has been drawn up in accordance with approved accounting standards so as to give a true and fair view of the state of affairs of IDSM. The fourth defendant also signed a statutory declaration declaring himself as the director primarily responsible for the accounting records and financial management of IDSM and that the 2004 audited accounts are to the best of his knowledge and belief true and correct. Both the first and second defendants denied any knowledge of the removal of IDSM's physical assets and stocks to China Enersave Ltd for zero consideration. Both the first and second defendants were not involved in the deed of assignment of the trade receivables. The first and second defendants were not party to the carrying on of the business in the manner. It is clear that throughout the period in question the management of IDSM was in the control of the third and fourth defendants. The 'statement by directors' made by the third and fourth defendants in the 2004 audited accounts and the statutory declaration by the fourth defendant as the director primarily responsible for the accounting records and financial management of IDSM point directly to their role in carrying out the business of IDSM. The ultimate beneficiary of the transfer of the trade receivables and physical assets and stocks is China Enersave Ltd. The entire business was managed and controlled by the third and fourth defendants qua directors of IDSM. They acted knowingly in the service of China Enersave Ltd. They were nominated to be directors of IDSM by China Enersave Ltd to safeguard China Enersave Ltd's interests.

[28] For the foregoing reasons the court makes the following orders:

(a) The claim against the first and second defendant is dismissed with costs;

(b) A declaration that the third and fourth defendants as directors of the fifth defendant are personally responsible, jointly and severally, to the plaintiff for the judgment debt of US$90,858.01 (or the equivalent in Ringgit Malaysia on the date of the order hereof) due and owing by the fifth defendant to the plaintiff;

(c) The third and fourth defendants are, jointly and severally, to forthwith pay to the plaintiff the judgment debt of US$90,858.01 (or the equivalent in Ringgit Malaysia on the date of the order hereof) due and owing by the fifth defendant to the plaintiff;

(d) The third and fourth defendants are, jointly and severally, to forthwith pay to the plaintiff interest on the judgment debt of US$90,858.01 at the rate of 8%pa calculated from 16 February 2004 until full satisfaction of the judgment debt;

(e) Costs to be paid by the third and fourth defendants; and

(f) The security for costs provided by the plaintiff is to be released to the plaintiff.

The plaintiff's claim against the first and second defendants dismissed with costs. The third and fourth defendants personally responsible, jointly and severally to the plaintiff with interest and costs.

Reported by Kohila Nesan